IN THE

Supreme Court of the United States

October Term, 1946 No. 48

WALTER J. ROTHENSIES, Individually, and as United States Collector of Internal Revenue for the First District of Pennsylvania,

Petitioner

v.

THE ELECTRIC STORAGE BATTERY COMPANY, a Corporation

BRIEF FOR RESPONDENT

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SUPREME COURT OF THE UNITED STATES

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v.

THE ELECTRIC STORAGE BATTERY COMPANY, a corporation.

BRIEF FOR [illegible]SPONDENT

I. OPINIONS OF COURTS BELOW

Electric Storage Battery Company v. Rothensies (1944) 57 F. Supp. 731 (R. 37-45).

Electric Storage Battery Company v. Rothensies (CCA3-1945) 152 F. 2nd 521 (R. 48-55).

II. JURISDICTION.

1. The jurisdiction of this Court is invoked under the Judicial Code, Section 240 (a), as amended by the Act of February 13, 1925, ch. 229, 43 Stat. 938 (28 USCA § 347).

2. The judgment of the Circuit Court of Appeals was entered on November 27, 1945 (R. 55-56).

III. QUESTIONS PRESENTED.

1. Where the Government illegally collected money prior to 1928 from a corporation under the guise of excise taxes, part of which it later refunded and made a deficiency income and excess profits tax assessment on the refund, is not the corporation entitled to recoup the moneys not refunded against the deficiency assessment?

2. Where the Government illegally collects money under the guise of excise taxes in one year, and the money is refunded in a later year, must not the money refunded be considered income for tax purposes in the year in which it was originally earned by the taxpayer rather than the year in which the Government paid the refund?

IV. STATEMENT OF THE CASE.

For the period of the seven years between March 1, 1919, and February 28, 1926, the Government illegally exacted 84 monthly payments from the respondent as excise taxes on the respondent's sales of electric storage batteries upon the erroneous theory that the batteries were parts of automobiles (R. 22, 27, 37). All of the assessments were upon the same type of batteries (R. 33). In 1935, as a result of litigation instituted by the respondent, the Government refunded the last 45 payments, these being the payments made between 1922 and 1926 (R. 24-25; 38). The Government treated this refund as income in the year 1935 and assessed a deficiency income and excess profits tax on the refund which, together with interest, amounted to $229,805.34 (R. 26, 38). The respondent sought to recoup against this assessment the first 39 monthly payments which had been made between 1919 and 1922 and which the respondent had not asked to recover in the prior litigation because of the bar of the statute of limitations (R. 7, 15, 29, 34, 38). The total amount of the payments made between 1919 and 1922 and which the respondent had absorbed itself is $534,205.04 (R. 33, 38). After the Government rejected the respondent's argument that it had a defense by way of recoupment to the entire deficiency assessment (and its additional argument that the refund received in 1935 was not 1935 income for tax purposes), the respondent paid this additional tax to the petitioner under protest (R. 26). After a claim for refund was denied, this suit was instituted to recover the payment and to obtain an adjudication of the validity of the recoupment defense and a determination of the question whether the refund was taxable as 1935 income (R. 38, 49).

The money the respondent paid to the petitioner and which it seeks to recover from him in this litigation was paid by him to the Treasurer of the United States, as required by law: 26 U.S.C. § 3950. The moneys the respond-

ent seeks to recoup were also paid by the Collector to the Treasurer of the United States, as required by law (R. 29, 33).

The District Court found that even after the Government is given credit for the respondent's income tax savings arising out of credits taken for the payment of all the excise taxes, the Government still has in its hands more of the respondent's money than the amount of the 1935 deficiency tax assessment (R. 44). The following calculation shows the situation exactly:

Respondent's 1919-1922 net payments of excise taxes (R. 33, 38)		$534,205.04
Respondent's income tax savings on 1919-1922 excise tax payments (R. 29)	$178,691.52	
Respondent's income tax savings on 1922-1926 payments (R. 23)	139,668.83	
		318,360.35
Net overpayment withheld by Government		$215,844.69
Additional 1935 income and excess profits taxes demanded and collected by Government (R. 26)		198,023.87
Overpayment by respondent after recoupment		$17,820.82

Although the total deficiency assessment paid in 1938 and based on the 1935 refund was $229,805.34, this was made up of additional tax of $198,023.87 plus interest thereon to the date of payment in 1938 of $31,781.47 (R. 26).

V. ARGUMENT.

SUMMARY.

Point 1. The common law doctrine of recoupment as applied in actions at law for more than a century is applicable to the present facts.

Point 2. Sections 608(a) and 609(b) of the Revenue Act of 1928 do not destroy respondent's substantive right of recoupment because (1) they do not purport to affect the jurisdiction of Federal Courts and (2) they do not destroy a substantive right of recoupment which a taxpayer had on their effective date.

Point 3. There is no basic inconsistency or confusion in the decisions of this Court when properly analyzed and understood.

Point 4. The rule that a taxpayer may not recover from one Collector of Internal Revenue moneys wrongfully paid to a predecessor collector has no application to the present case because the respondent only seeks to recover from the petitioner moneys paid to him which he had no right to collect.

Point 5. The moneys paid to the respondent in 1935 as a refund of moneys illegally exacted from the respondent in the years 1922 to 1926 were improperly assessed as income in 1935 and should be treated as income in the earlier years.

Point 1.

The common law doctrine of recoupment as applied in actions at law for more than a century is applicable to the present facts.

1. The Facts and the Doctrine of Equitable Recoupment.

We start off in this case with the fact, proved by evidence and found by the Court (R. 33, 38), that the Government has collected from the respondent $534,205.04 under the guise of excise taxes on parts of automobiles, to which it was not entitled and no part of which has ever been returned. It is not the case of a miscalculation of the amount of a valid tax. No tax in any amount was due on the sale of respondent's storage batteries. The amount demanded by the Government and paid protestingly under duress (Request 17 and conclusion 5 affirmed: R. 32, 34, 45) was an illegal exaction from start to finish. It was money which, both in law and good morals, at all times belonged to the respondent but which the Government, by its superior power, compelled the respondent to pay to it.

In 1935 the Government recognized this with respect to other similar payments illegally exacted and repaid the respondent principal and interest totalling $1,395,515.35 to satisfy its judgment. The Government treated this entire repayment as income in the year 1935 and assessed additional income and excess profits taxes on it totalling $229,805.34.

These 1935 tax claims arose because of repayments by the Government of moneys it recognized had been illegally exacted. The respondent answers the Government's claim thusly: You cannot make me pay you money as taxes on the moneys you have disgorged when you still hold other moneys of mine (in a larger sum than the proposed tax) which you illegally exacted in the same manner as the money you have repaid but which I cannot compel you to disgorge at this late date. The least you can do is to use the rest of *my* money, to satisfy your claim for taxes on what I have made you pay back."

Would this have been an adequate defense to a suit by the Government for the additional 1935 tax? If so, the decision of the Circuit Court of Appeals is correct. The

present respondent's rights in that respect are not changed by reason of the fact that instead of waiting to be sued it paid the additional 1935 tax assessment under protest, filed a petition for refund, and then sued the same collector who received this payment to get it back. That point was settled in Bull v. United States (1935), 295 U.S. 247, discussed hereafter.

Judge Kirkpatrick found as a fact (by affirming the respondent's 20th request) that the respondent paid the Government, out of its own pocket, $534,205.04 for claimed excise taxes, which the Government still holds (R. 33, 45). He also stated this as a proved fact in his opinion (R. 38). It is stipulated that this money, as well as the additional 1935 income and excess profits taxes, were in usual course received by the Treasurer of the United States (R. 29).

On such facts it cannot be denied that the Government has been unjustly enriched at the respondent's expense, to the extent of the $534,205.04 it illegally extracted by duress from the respondent between 1919 and 1922. And when the Government finally recognizes that its gains are ill gotten and pays back part of them, on which it assesses another tax, every concept of equity and good conscience requires the Government to credit against this tax the additional moneys of the respondent which it still holds. Except for the bar of the statute of limitations, there is no doubt but that the respondent could have obtained a judgment for this $534,205.04, which represented the first 39 illegal monthly exactions, just as it did obtain a judgment for the amounts which represented the last 45 illegal monthly exactions. But while the statute of limitations does bar a direct action, general concepts of equity and good conscience require the application of the defense of equitable recoupment to the Government's claim for 1935 taxes.

The leading case on this question, with respect to Federal taxes, is Bull v. United States (1935) 295 U.S. 247. In that case the Commissioner assessed a deficiency

income tax against an executor for partnership profits earned after decedent's death. The executor had treated them as corpus of the estate and had paid estate tax on them. The Court held that even though the statute of limitations barred a recovery of the overpaid estate tax, the Government was required to credit it against the income tax claim, and that, inasmuch as the executor had actually paid the income tax, he was entitled to a judgment in the amount of the overpayment of estate tax. In that case the executor could recover only part of the income tax payment because the overpayment of estate tax was in a lesser sum. In the present case, the illegal exaction for "excise taxes" is much greater than the 1935 tax, which was paid, so the entire payment is recoverable.

Speaking for a unanimous court, Mr. Justice Roberts said (pp. 260-262):

> "In a proceeding for the collection of estate tax, the United States through a palpable mistake took more than it was entitled to. Retention of the money was against morality and conscience. But claim for refund or credit was not presented or action instituted for restitution within the period fixed by the statute of limitations. If nothing further had occurred Congressional action would have been the sole avenue of redress.
>
> In July, 1925, the Government brought a new proceeding arising out of the same transaction involved in the earlier proceeding. This time, however, its claim was for income tax. The taxpayer opposed payment in full, by demanding recoupment of the amount mistakenly collected as estate tax and wrongfully retained. Had the Government instituted an action at law, the defense would have been good. . . . While here the money was taken through mistake without any element of fraud, the unjust detention is immoral and amounts in law to a fraud on the tax-

payer's rights. . . . . If the claim for income tax deficiency had been the subject of a suit, any counter demand for recoupment of the overpayment of estate tax could have been asserted by way of defense and credit obtained notwithstanding the statute of limitations had barred an independent suit against the Government therefor. This is because recoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded. Such a defense is never barred by the statute of limitations so long as the main action itself is timely."

He added (p. 263):

"It is immaterial that in the second case, owing to the summary nature of the remedy, the taxpayer was required to pay the tax and afterwards seek refundment. This procedural requirement does not obliterate his substantial right to rely on his cross-demand for credit of the amount which if the United States had sued him for income tax he could have recouped against his liability on that score."

This doctrine of equitable recoupment was next approved by this Court in Stone v. White (1937) 301 U.S. 532 and applied in favor of the Government. A trustee had erroneously paid an income tax on income taxable to the beneficiary. After the Government's claim against the beneficiary had been barred, the trustee sued to recover his payment. Mr. Justice Stone said (p. 539):

"The Government, by retaining the tax paid by the trustees, is not reviving a stale claim. Its defense, which inheres in the cause of action, is comparable to an equitable recoupment or diminution of petitioner's right to recover. 'Such a defense is never barred by the statute of limitations so long as the main action itself is timely.' Bull v. United States, 295 U.S. 247, 262."

These two decisions have been cited very recently and with apparent approval by this Court in **Commissioner v. Gooch Milling and Elevator Co.** (1943) 320 U.S. 418, 421, in which, however, the scope of equitable recoupment was not before the Court for consideration.

The doctrine was applied in **Crossett Lumber Co. v. United States** (CCA 8, 1937) 87 F. (2d) 930, 932, in which the Court said:

> "Further, the equitable basis for the doctrine of recoupment has peculiar application to actions to recover taxes. The basis of the doctrine is that principle of natural justice which denounces a claim as unjust, immoral, and fraudulent when the claimant is at the same time wrongfully withholding money which in equity belongs to the other party."

In 1943 the Eighth Circuit Court of Appeals again applied the doctrine of equitable recoupment, this time in favor of the taxpayer, in **Gooch Milling & Elevator Co. v. Commissioner** (CCA 8, 1943) 133 F. (2d) 131. The Commissioner assessed an income tax deficiency for 1936 and the taxpayer sought to recoup an overpayment of 1935 income tax, refund of which was barred. The Board of Tax Appeals held it had no jurisdiction to apply the doctrine of equitable recoupment. The Circuit Court of Appeals reversed and held that (1) the Board did have jurisdiction, (2) the doctrine was applicable on the facts, and (3) in any event the Court itself had power to apply the doctrine. The Court said (p. 135):

> "In this situation a manifest wrong results if the administrative tribunal or the court is powerless to prevent an unjust enrichment of one of the parties before it. Recoupment is purely defensive and is equitable in its nature. It reduces the claim affirmatively urged so far as in reason and conscience it ought."

One judge dissented, but only on the question of the Board's jurisdiction, and on this "sole question" this Court

reversed: **Commissioner v. Gooch Milling & Elevator Co.** (1943) 320 U.S. 418. Significantly the Court said: "We are not called upon to determine the scope of equitable recoupment when it is asserted in a suit for refund of taxes *in tribunals possessing general equity jurisdiction.* cf. Bull v. United States, 295 U.S. 247, Stone v. White, 301 U.S. 532" (p. 421 Italics added). Consequently the decision of the Circuit Court of Appeals concerning *the facts to which equitable recoupment is applicable* stands unimpaired when such facts are established in a District Court, which does possess "general equity jurisdiction."

Judge Kirkpatrick said that **Dixie Margarine Co. v. Commissioner** (CCA 6, 1940) 115 F. (2d) 445 "is on all fours with the present case" (R. 43). In that case the Government illegally collected moneys between 1923 and 1931 from Dixie on the erroneous theory its products were taxable under the Federal Oleomargarine Act. In 1932 the Government paid back the moneys illegally exacted between 1925 and 1931 but did not pay back $87,412 which had been collected between 1923 and 1925, recovery of which was barred by the statute of limitations. The Commissioner then assessed a deficiency 1932 income tax on the refunds and Dixie sought to recoup the amounts illegally exacted during the years 1923 to 1925. The case arose in the Board of Tax Appeals and it rejected the defense: 38 B.T.A. 471. The Sixth Circuit Court of Appeals reversed.

In the case at bar the Government concedes that this case is against it but contended in the Circuit Court of Appeals that Judge Arant's opinion does "not even have the status of dictum" (Petitioner's Brief in the C. C. A. p. 27). The Government sought unsuccessfully in the Circuit Court of Appeals to justify this summary waiving aside of a unanimous 1940 decision of the Sixth Circuit Court of Appeals by the following ingenious and wholly fallacious chain of reasoning:

> The Dixie case arose in the Board of Tax Appeals. The Board refused to apply the doctrine of equitable recoupment. The Court reversed. In the Gooch case the Supreme Court held, three years later, that the Board had no jurisdiction to hear such a defense and that the Eighth Circuit Court of Appeals had erred in deciding the contrary. Ergo, the Sixth Circuit Court of Appeals erred in the Dixie case in reversing the Board and directing it to apply that doctrine and its decision is now discredited.

The fallacy of this reasoning is that it does not distinguish between the factual situation to which the doctrine of equitable recoupment is applicable and the jurisdiction of the particular tribunal in which the facts are presented to apply that doctrine. In view of the Gooch case we concede that on an appeal from the Tax Court, which is the successor to the Board of Tax Appeals (but not on an appeal from a District Court), a different result than that reached in the Dixie case would now be required, but only because of the limited statutory jurisdiction of the Tax Court. However, no jurisdictional question was considered in the Dixie case either by the Board or by the Court. The opinion is concerned solely with determining whether the facts in that case (which most certainly are "on all fours", as Judge Kirkpatrick said, with the present facts) called for the application of equitable recoupment. The Court there held that they did. On this question of substantive law the case is as good authority today as the day it was decided; and as Judge Kirkpatrick sat as a District Court which does possess "general equity jurisdiction" he quite properly looked upon the Dixie case as persuasive authority and "directly in line with the trend shown by the decisions of the Supreme Court" (R. 43). We submit that this case was correctly decided on the merits and that Judge Arant's opinion fully sustains the conclusions he reached. It is persuasive authority of un-

usual weight because it accords so fully with established principles of equity and fair dealing.

Judge Kirkpatrick well said: "the equities are so plain as to admit of no disagreement among just and reasonable men. Every consideration of fair dealing demands that the taxpayer be credited as against its present liability with the taxes which it has been illegally compelled to pay, and I think that the decisions of the courts fully justify such a solution" (R. 42-43). The Circuit Court of Appeals quoted from this language and said "as to the fairness of the matter, we agree with the District Court . . .": R. 51.

Other decisions, in addition to those already cited, which sustain the judgment in this case include **Dunigan v. United States** (Ct. of Cl. 1938) 23 F. Supp. 467 and **Mills v. United States** (D.C. N.Y., 1940) 35 F. Supp. 738.

2. The Scope of the Doctrine of Equitable Recoupment.

The Government seeks to avoid the application of the doctrine of equitable recoupment to the present facts by contending that the payments "sought to be recouped, did not arise out of the same transaction as the income taxes for 1935 . . ." (Petitioner's Brief, pp. 8-9).

"What meaning have the Courts given to the words "the same transaction"?

"A word is not a crystal, transparent and unchanged; it is the skin of a living thought and may vary greatly in color and content according to the circumstances and the time in which it is used." [1]

This Court itself has said: " 'Transaction' is a word of flexible meaning. It may comprehend a series of many occurrences, depending not so much upon the immediateness of their connection as upon their logical relationship": **Moore v. New York Cotton Exchange** (1926), 270 U.S. 593, 610. The Court was there considering the meaning of the word in Equity Rule 30 permitting "any counter-

[1] *Towne v. Eisner* (1918), 245 U.S. 418, 425, per Holmes, J.

claim arising out of the *transaction* which is the subject-matter of the suit." The Court construed it broadly because "To hold otherwise would be to rob this branch of the rule of all serviceable meaning."

In an early case on recoupment, part of the language of which was later adopted by Waterman in his text book definition, the Illinois Court said that recoupment "adjusts by one action adverse claims growing out of the same subject matter. . . . It is not necessary that the opposing claims should be of the same character. . . . *It is sufficient that the counterclaims arise out of the same subject matter, and that they are susceptible of adjustment in one action*": Stow v. Yarwood (1853), 14 Ill. 424, 426-27 (Italics added).

The italicized language was incorporated into Waterman's discussion distinguishing recoupment from set-off. He said recoupment is "confined to matters arising out of, and connected with, the transaction or contract upon which the suit is brought" and went on to repeat the italicized language from the Stow case: **Waterman on Setoff, Recoupment and Counterclaims** (2d ed. 1872), p. 480.

In **Bull v. United States**, supra, Mr. Justice Roberts said "recoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded": 295 U.S. 262.

In **Mills v. United States**, supra, the Court said "The doctrine of recoupment is not limited to a claim arising directly from the particular contract sued upon. It is sufficient if it arises out of the same subject matter, and that the claims are susceptible of adjustment in one action": 35 F. Supp. 739.

In **Crossett Lumber Co. v. United States**, supra, Judge Thomas said "the equitable basis for the doctrine of recoupment has peculiar applications to actions to recover taxes": 87 F. (2d) 932.

In Mr. McConnell's article on "The Doctrine of Recoupment in Federal Taxation" (1942), 28 Va. L. Rev. 577,

he said that "recoupment is at present an appropriate device to render fundamental justice and equity in situations where a strict adherence to the terms of the statutes of limitation would result in unfairness."

In the light of these expressions let us examine the present facts. During the 7 years between March 1, 1919 and February 28, 1926, the Government illegally exacted 84 monthly payments from the respondent. They were all based on the same taxing statute because Section 900 of the Revenue Act of 1921, levying an excise tax on parts of automobiles, was merely a reenactment of Section 900 of the Revenue Act of 1918. All 84 payments were based on respondent's sales of electric storage batteries. The storage batteries sold by the respondent and upon which "excise taxes" were paid during the first 39 months were the same type of batteries sold by respondent during the last 45 months of the 7-year period (This fact is specifically covered by the plaintiff's 23d Request for Fact Findings which was affirmed by the Court: R. 33, 45). When the Government refunded the last 45 payments and assessed a 1935 deficiency income tax on the refund the respondent asked to recoup the first 39 payments.

This exactly fits this Court's statement, quoted above from the Moore case, that the word "transaction" "may comprehend a series of many occurrences, depending not so much upon the immediateness of their connection as upon their logical relationship."

The procedural requirement that the original demand and claim for recoupment be "susceptible of adjustment in one action" is clearly met.

The recoupment doctrine came into the law to promote justice. It should be liberally applied to accomplish that end wherever that can be done without undue procedural or administrative difficulty and no rule of public policy prevents it. It is obvious that unless its convenient application to this case is sustained the respondent can derive no benefit from the more than half million dollars of its

money, obtained originally by duress, which the Government holds. Words are devices to promote the transmission of thought. The "living thought" that lies within "recoupment" cannot be stifled by mere pedantry.

3. Comments Upon the Petitioner's Argument Concerning Recoupment.

Acceptance of the petitioner's argument requires one to forget that "The doctrine of recoupment is based on concepts of fairness." (R. 50-51). Petitioner argues at length that the present facts are different from those in *Bull v. United States* and in *Stone v. White*, and the first reason stated in the petition for certiorari (p. 8) was that the decision in the present case is "an unwarranted extension of the principle of the *Bull* case." But the latter case did not purport to define the scope of recoupment in tax cases or set forth the limits of its application, other than by saying "recoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded": 295 U.S. 247, 262. This Court did not there define the word "transaction". The important thing was that "the United States through a palpable mistake took more than it was entitled to" and "Retention of the money was against morality and conscience": 295 U.S. 247, 260. For this reason the recoupment defense was sustained. The language just quoted is no less apposite in describing the facts in the present case. As recoupment "is a product of judicial action" (Petitioner's Brief p. 19, note 7) it has sufficient flexibility to perform the function for which it was created even though the particular facts vary from case to case. The minute that ceases to be true and the rule is viewed as having the rigidity of a fifteenth century writ it becomes a deterrent, rather than an aid, to obtaining a fair and just result.

Much of the petitioner's argument disregards the fact that recoupment grew up in the common law and need not

look to legislation for any support. Petitioner stresses that Sections 3228 and 3226 of the Revised Statutes "form part of a system of corrective justice in respect of the assessment and collection of erroneous or illegal taxes" and that "this system . . . was intended to comprehend the entire subject, including all claims for refund" (Petitioner's Brief, p. 13). The answer to that is that after this system was established this Court unanimously decided the *Bull* case in 1935.

Of course those statutory limitations barred any direct claim or suit for refund of the respondent's half million dollars the Government had compelled it to pay and wrongfully retained. But the statement that "The courts have not been vested with general jurisdiction to grant a refund of taxes upon equitable principles where the taxes have been exacted according to law" (Petitioner's Brief p. 17) confuses (1) the Court's lack of power to grant a judgment in the taxpayer's favor in a too late suit by him to recover taxes erroneously paid with (2) the Court's recognized power to permit the taxpayer to plead recoupment by way of defense when the Government sues to recover another tax arising out of the same transaction, or "the same subject matter." And if Collector Rothensies had attempted to discharge his "statutory duty to collect the (1935) assessment" (Petitioner's Brief p. 16) by suing the respondent in the District Court that Court would have had "general equity jurisdiction" to hear and apply the recoupment defense. So too, under the *Bull* case, the District Court *does* have power to "grant a refund . . . . upon equitable principles" of the 1935 income taxes which respondent paid and then sued to recover in order to raise the recoupment defense. Hence it does *not* "follow that there could be no recovery by suit of those (1935 income) taxes" (Petitioner's Brief, p. 17).

The petitioner further disregards the reason for the rule of recoupment by arguing that the rule as applied in the *Bull* case is not applicable here "because recovery of

the excise taxes was barred when the Commissioner proceeded to collect the income tax" (Petitioner's Brief, p. 18), whereas in the *Bull* case "recovery was predicated on the fact that when the Government proceeded against the taxpayer to collect a second tax on the identical sum of money, refund of the first tax was not barred" (p. 21). As we read the opinion it seems clear that recovery was *not* predicated on the stated fact, nor was it a controlling fact. Certainly there is nothing in the opinions in *Stone v. White* or in McEachern v. Rose (1937) 302 U.S. 56 to suggest that such fact is of any legal significance. Indeed, in the latter case, in which the Government's claim to recoup was based on a claim which *was* barred when the taxpayer took action to collect the overpaid income tax Justice Stone said: "We may assume that, in the circumstances, equitable principles would preclude recovery in the absence of any statutory provision requiring a different result": 302 U.S. 56, 59. The petitioner's argument is certainly contrary to that assumption. It is also contrary to the statement in the *Bull* case, which was quoted with approval in *Stone v. White* that the defense of recoupment "is never barred by the statute of limitations so long as the main action itself is timely": 295 U.S. 247, 262. Indeed, it is difficult to reconcile petitioner's argument on this point with his further statement (p. 19, note 7) that "Since recoupment *is purely defensive* and arises out of and inheres in the plaintiff's claim and advances reasons why the court should not use its processes to enforce an inequitable claim of the plaintiff, *the defense is considered to survive as long as the plaintiff's cause of action exists, although an affirmative action by the defendant upon the subject of the claim may be barred by the statute of limitations*" (Italics added.)

This accurate statement is also the answer to petitioner's conclusion that "If the purpose of a statute of limitations is repose, it is completely frustrated by the decisions below" (p. 23). One can keep his repose and the other's money as well, but when he chooses to seek more money

from the other he cannot object to that slight disturbance of repose which may result from the defensive plea of recoupment. The Government could have continued to enjoy complete repose even though it had in its pocket some $534,000 of respondent's money which didn't belong to it. It chose to disturb that repose by asking the respondent for $229,000 more out of the partial refund of the illegally collected excise taxes. That disturbed the respondent's repose also and led it to remind the Government about the other $534,000. This amount of disturbance of repose is inevitable in any recoupment case. When the statute of limitations has not run there is no need for the rule of recoupment; the defense of set-off is sufficient.

Petitioner says in his brief (p. 25) that "the principle of recoupment may serve a desirable end". (This seems inconsistent with the position earlier taken (p. 13) that the statutes alone were "intended to comprehend the entire subject".) Petitioner adds that recoupment "should not be applied in such a manner as to result in a direct conflict with the statutory purpose" and that as applied in this case it does "result in such conflict" (p. 26). But the facts do not show a Congressional intent in conflict with the result in this case. The facts are that seven years after the Revenue Act of 1928 was enacted (which petitioner claims destroyed a taxpayer's defense of recoupment) this Court recognized the taxpayer's right of recoupment in the *Bull* case. The report of the Committee on Finance on Section 820 of the Revenue Act of 1938 (quoted in Petitioner's Brief p. 25, note 11) which came three years later does not disapprove of the *Bull* case or of the rule of recoupment. On the contrary it refers to the need for legislation "*to supplement* the equitable principles applied by the courts. . . ." The fact that this supplementary legislation dealt with one phase of the situation involving only income tax adjustments reveals no statutory purpose to destroy the recoupment doctrine in tax cases or limit the courts in determining its proper scope. Section 820, which

provides for mitigation of the effect of the statute of limitations in income tax cases where there has been an erroneous treatment of an item of income, deduction, or basis of property in another year and permits recovery of a refund notwithstanding the fact that the statute of limitations has run, has nothing to do with this case. It is concerned solely with adjustments of income taxes in taxable years subsequent to January 1, 1932, and the respondent's right to recoup payments of *excise* taxes illegally collected arose long before that date. Judge Kirkpatrick decided that Section 820 did not lessen any right which accrued before January 1, 1932 (R. 44). The same construction has been given to it by the Court of Claims (**Lynchburg Coal & Coke Co. v. United States** (1942) 47 F. Supp. 916, 921) and by Judge Evans in the Seventh Circuit: **American Light & Traction Co. v. Harrison** (CCA 7, 1944) 142 F. 2d 639, 645.

Petitioner says that "The doctrine of recoupment has been applied primarily in cases where there has been *inconsistent* treatment for tax purposes of the same item or event . . ." (Petitioner's Brief p. 27). This sort of case is an obvious example of a type of case likely to arise. But the tax cases, particularly in this Court, are too few to establish any definite boundaries of inclusion or exclusion. To limit recoupment to this one type of case, just because it was the first to arise in tax litigation, requires one to look so intently at the facts of the case as to forget to look up and see the rule emerging from them. It reminds one of the earlier torts decisions denying a manufacturer's liability to a third person unless his injury came from something intended "to destroy, preserve or affect human life" and the cases involved foods, drugs, chemicals and firearms. It remained for Judge Cardozo in **MacPherson v. Buick Motor Co.** (1916) 217 N.Y. 382 to show that these were merely *examples* of situations in which the rule of liability should be applied and that it was equally applicable to other sets of facts.

Certainly if "an inconsistent treatment of the same item" which causes a "particularly harsh" result when the statute of limitations is applied is the reason which justified the Court in applying recoupment (as petitioner says on page 28 of his brief) there is no less reason for relief in the present case. It is no less "particularly harsh" for the Government to say to respondent "I shall pay you back some of the excise taxes I illegally compelled you to pay, but I shall get part of that back by taxing you on the refund; and I shall give you no credit whatever for the taxes I still withhold even though they exceed the new tax on the refund."

Petitioner errs in his Brief when he states "that there was no inequity in the imposition of the income taxes upon the refund of the 1922 to 1926 excise taxes, for the taxpayer had deducted those excise taxes in its income tax returns for the years 1922 to 1926 and thereby had secured a tax benefit equal to the 1935 income taxes" (p. 30). Actually the income tax saving for 1922-26 was $139,668.83 (R. 23) whereas the 1935 assessment was $198,023.87 and with interest added totalled $229,805.34 (R. 26).

But more than this, petitioner in his statement omits reference to the fact that the Government had previously illegally collected from the respondent $534,205.04 under the guise of excise taxes to which it was not entitled and no part of which has ever been returned. The inequity arises, not because of the imposition of the income taxes upon the refund of the 1922 to 1926 excise taxes, but upon the failure of the Government to credit against that imposition of income taxes the funds illegally exacted as excise taxes for the years 1919 to 1922 in the amount of $534,205.04, which amount was more than sufficient to cover the income tax for 1935 and the tax benefit by reason of the deduction of the excise taxes in income tax returns for the years 1922 to 1926. Both Courts below agreed as to the inequity of this situation (R. 43, 51).

Finally, the petitioner views with alarm applying re-

coupment to the present case because it offers "almost limitless opportunities for circumventing the statute of limitations and the periodical system of federal tax accounting. . . ." (Petitioner's Brief p. 25). "Almost limitless opportunities" in fact comprise only opportunities to plead recoupment defensively in cases in which the defense (a) arises "out of some feature of the transaction upon which the plaintiff's action is grounded" (295 U.S. 247, 262), and (b) can "be expediently tried with the plaintiff's case" (R. 50) and (c) is necessary to prevent unjust enrichment. In the present case two courts have said that "Every consideration of fair dealing demands that the taxpayer be credited as against its present liability with the taxes which it has been *illegally compelled* to pay, . . ." (R. 43, 51 Italics added). Is the petitioner's quoted opinion as to the future results of granting credit on such facts a sound one? Our opinion is that experience will prove that the forebodings of disaster came from the tongues of false prophets.

Point 2.

Sections 608(a) and 609(b) of the Revenue Act of 1928 do not destroy respondent's substantive right of recoupment because (1) they do not purport to affect the jurisdiction of Federal Courts and (2) they do not destroy a substantive right of recoupment which a taxpayer had on their effective date.

Point 3.

There is no basic inconsistency or confusion in the decisions of this Court when properly analyzed and understood.

1. The Sections do not Change the Jurisdiction of Federal Courts.

The first reason why these sections do not bar the taxpayer from asserting the doctrine of equitable recoupment in a court possessing general equity jurisdiction is that they were enacted as "Administrative Provisions" to

govern the Commissioner of Internal Revenue in making "a refund" or giving "a credit". They do not purport to deprive a court of jurisdiction to hear and determine a plea of recoupment. The language used is inapplicable to a court which does not make "a refund" or give "a credit" in a lawsuit but enters a judgment. It is significant that these sections are a part of "TITLE IV—ADMINISTRATIVE PROVISIONS" of the Revenue Act of 1928, which contains numerous other purely administrative provisions. It is also significant that in the Internal Revenue Code of 1939 these sections (3774(a) and 3775(b)) are found under "SUBTITLE D, GENERAL ADMINISTRATIVE PROVISIONS" and in "*Chapter 37, Abatements, Credits and Refunds*". Such headings are pertinent in interpreting a statute: 50 *American Jurisprudence* 467, 468; **Knowlton v. Moore (1900)**, 178 U.S. 41. If Congress had intended to take away from the Courts the power to apply the doctrine of recoupment it would have been a simple matter to have done so in clear language and in an appropriate section, such as Section 617 of the Revenue Act of 1928 which deals with "Jurisdiction of Courts".

If Congress had intended to take away the jurisdiction of Federal Courts to apply the doctrine of equitable recoupment in tax cases it would have said "No Court of the United States shall have jurisdiction to hear and adjudicate a plea of recoupment in a tax case" or words of similar import. That is the sort of language which is found in the Norris-LaGuardia Act which withdrew from Federal Courts most of their jurisdiction to give equitable relief in labor disputes: 29 U.S.C. §§104, 105, 107.

Such expressions as "credit of an overpayment", "credit against a liability" and "refund", are typical Bureau of Internal Revenue expressions frequently found in mimeographed directions to Collectors of Internal Revenue. Certainly they are not sufficient to deprive a District Court of its established jurisdiction to apply the ancient doctrine of recoupment in favor of a taxpayer.

In **Lyeth v. Hoey** (CCA 2, 1940), 112 F. (2d) 4, 9-10 (discussed thereafter), Judge Clark, in a dissenting opinion, said on this point:

> "Had it been intended to prohibit any credit for any federal tax after the period of limitation had run, the natural course would have been to express this prohibition directly. Thus it could have been provided that a barred tax could be neither affirmatively collected nor used as an offset against the taxpayer's claim for refund. But this statement seems studiously to have been avoided. Instead the statute refers to the converse situation, to make void not the barred claim, but the refund credit. This backhanded form of statement is not clear unless it is read as emphasizing the administrative process of making a credit. A direct payment of the barred claim is made recoverable under the earlier section, § 607; so here it is added that the attempt to make a credit towards it is simply a void act.
>
> "Such careful use of terms would be unusual if credit meant substantially any tax claim, as my brothers view it. It does, however, tie in with the limited and careful use of the term credit in the revenue laws, where it does not appear as a synonym for general setoff. It does appear in § 322(a) with reference to the income tax only as pointed out above; its use elsewhere is limited. . . .
>
> "In the revenue laws, therefore, the word credit seems to be a word of art, having a specific denotation, rather than a word of broad and indefinite generality. This is more than a mere matter of adding or subtracting payments or refunds, or of the form which the checks to settle the balance should take. It is a matter of substance, to wit, what agency of government has the responsibility of passing on difficult questions of equitable recoupment beyond the fairly

simple situations covered by section 322(a). To date the principles of such recoupment have been only partially developed by the Supreme Court. It seems, therefore, that those are problems for the courts."

However, where a taxpayer sues to recover an admitted overpayment there are strong reasons of public policy against permitting the Government to defeat the action by contending it has not been unjustly enriched by the overpayment. It is of enormous administrative importance in the collection of taxes for taxpayers to feel that they can make prompt payment of taxes claimed from them with assurance that if that particular tax is excessive the overpayment will be refunded or credited against another collectible tax liability. *A taxpayer who pays a tax demand should not be in a worse position than one who compels the Government to proceed against him.* The latter taxpayer will successfully defend the suit to collect the over-assessment, and, of course, he will not have to pay some earlier barred liability. *The good citizen who promptly pays the taxes demanded of him should be equally well off when he seeks a refund of his overpayment.* It would not only be unfair but enormously impede the collection of taxes if the Commissioner of Internal Revenue could by collection of amounts not due or barred by limitations place himself in a better position to *keep* such money than he would have been in to *collect* it, had he been compelled to sue. If he could thus improve his position by getting the money into his own hands it would become necessary to grant injunctions against the collections of overassessments, and the prompt and orderly collection of taxes would be thrown into a state of chaos.

Such reasons of policy seem to be back of Sections 607 and 609(a) of the Revenue Act of 1928 which provide that a payment made after the time within which it could have been collected "shall be considered an overpayment and shall be credited or refunded to the taxpayer" and which

prohibit the Commissioner from crediting the taxpayer's money against some unpaid tax, recovery of which is barred by limitations.

It is obvious that the reasons of policy behind Sections 607 and 609(a) which require the Commissioner voluntarily to refund the overpayment and which prohibit him from contending that *ex aequo et bono* the taxpayer is not entitled to recover, apply with equal force when the Commissioner disobeys the statutory mandate and the taxpayer brings suit to recover his overpayment. They bar the Government from contending it has not been unjustly enriched by getting possession of the overpayment.

It would be shocking to think that the Commissioner, by violating his statutory duty under Sections 607 and 609(a) to refund an overpayment and thereby compelling the taxpayer to enforce his statutory right by suit, could in that suit defeat the right of recovery by pleading he was not unjustly enriched in keeping the money the statute commanded him to pay over. If that could be done the Commissioner could completely frustrate the intent of Congress in every case by always compelling the taxpayer to sue and in each suit set up the so-called "equitable defense". No court should assist the Commissioner (or one of his Collectors of Internal Revenue) to evade his statutory duty by such a specious resort to rules of equity and good conscience. This thought was forcibly presented to the Supreme Court in the brief of an *Amicus Curiæ* in the much misunderstood case of **McEachern v. Rose** (1937), 302 U.S. 56, and was accepted by the Court. Mr. Justice Stone referred to Sections 607 and 609(a) of the act and said: "These provisions preclude the Government from taking any benefit from the taxpayer's overpayment by crediting it against an unpaid tax whose collection has been barred by limitation." (p. 60)

In view of the confusion among the profession as to what this case really stands for and the scope of its author-

ity, we have set forth a complete analysis of it in an appendix to this brief which appears on pages 1a-9a. It must be clearly understood that that case dealt solely with determining whether *the Government* could defend a suit to recover an overpayment by raising a general equitable defense.

An entirely different situation is presented when the Commissioner makes a deficiency assessment and seeks its collection from the taxpayer. If he has in his possession money he has illegally collected from the taxpayer arising out of the same transaction, Sections 608(a) and 609(b) may bar *him* from crediting it against the deficiency. But when the Collector sues the taxpayer to recover the deficiency assessment, there is no reason of policy to prevent the taxpayer from pleading recoupment. An administrative prohibition on the Commissioner does not affect the power of the Court to apply a doctrine which has been uniformly applied by Courts for many, many years. No public policy opposes such action by the Court. On the contrary, the public policy that justice should be done in our Courts requires the Court to permit the taxpayer to recoup against the deficiency tax claim.

The failure to see this distinction has caused most of the confusion with respect to the scope of the McEachern case. Its application should be limited *to what it held*, i.e., that in a suit by a taxpayer to recover an overpayment *which the statute entitles him to receive*, the Government cannot raise the equitable defense that keeping the overpayment does not result in unjust enrichment. But where the taxpayer is resisting a deficiency assessment under the pleaded defense of recoupment, then Bull v. United States is the controlling authority. It should not be overlooked that the suit in the Bull case was instituted *after* the effective date of the Revenue Act of 1928 but, nevertheless, the taxpayer's right of recoupment was sustained.

When the respective scope and application of these two cases is understood the apparent conflict between them

disappears and the cases fall into distinguishable patterns. In **Lyeth v. Hoey** (CCA 2, 1940), 112 F. (2d) 4, the taxpayer sued to recover an overpayment of 1933 income tax and the Government sought to recoup a barred estate tax deficiency assessed in 1938 (Note that the transaction was after the 1928 act became effective). The Court quite properly followed McEachern v. Rose which was the same type of case. Judge Clark's dissenting opinion, quoted on page 24 of this brief, correctly construed Sections 607, 608 and 609 as administrative provisions but overlooked the public policy which bars the Government from evading Sections 607 and 609(a) by forcing the taxpayer to sue. However, his dissenting opinion is entirely apposite to the facts presented in this case where no such policy is applicable. In several other cases the Government has unsuccessfully sought to raise an equitable defense to taxpayers' actions to recover overpayments: **American Light & Traction Co. v. Harrison** (CCA 7, 1944), 142 F. (2d) 639; **Grand Central Public Market v. U. S.** (D.C. Cal. 1938), 22 F. Supp. 119; **Crawford v. Heiner** (D.C. Pa. 1938), 23 F. Supp. 240; **Rotenberg v. Shechan** (D.C. Mo. 1943), 48 F. Supp. 584.

The two decisions in the Court of Claims cited on page 32 of the petitioner's brief are both cases in which the taxpayer did not prove that he had ever made a true overpayment out of which any right of recoupment could arise and, in addition, different transactions were probably involved. There is language, however, in the opinions which shows that the Court failed to see the distinction between cases falling within the rule of McEachern v. Rose and those falling within the rule of Bull v. United States.

The petitioner has not cited a single case in which a taxpayer who has clearly proved the Government had his money has not been permitted to recoup it where the elements of recoupment were present. In other words, no taxpayer who had a defense of recoupment, on proved

facts, has been barred from asserting it by the Act of 1928.

It is interesting to note the dissenting opinion of Judge Evans in **American Light & Traction Co. v. Harrison,** supra, in which the Court properly applied McEachern v. Rose and refused to permit the Government to recoup a barred 1928 tax against the taxpayer's claim to get back an overpayment of 1933 taxes. Judge Evans overlooked the rule of policy which bars the Government (but not the taxpayer) from pleading recoupment in a tax case, and argued strongly for the doctrine of recoupment. His failure to see that policy requires application of recoupment in a Bull case situation and rejection of it in a McEachern case situation, led him to describe the present law as "vexatious, perplexing and confusing". His opinion is a strong plea to apply recoupment to the facts of this case.

In adition, the decisions since McEachern v. Rose in which the taxpayer pleaded recoupment, have applied the Bull case and allowed the defense: **Dixie Margarine Co. v. Commissioner** (CCA 6, 1940), 115 F. (2d) 445 (which is on "all fours" with the present case and in which the Court followed the Bull case); **Gooch Milling & Elevator Co. v. Commissioner** (CCA 8, 1943), 133 F. (2d) 131, reversed on the "sole question" of jurisdiction in 320 U.S. 418; **Dunigan v. U. S.** (Ct. Cl. 1938), 23 F. Supp. 467. It may be noted that while this Court confined its decision in **Commissioner v. Gooch M. & E. Co.** (1943), 320 U.S. 418, to the jurisdictional question, it cited the Bull case with apparent approval and did not mention McEachern v. Rose. That assumes added significance in the light of the fact that the Government's brief in the Supreme Court in the Gooch case said on page 28: "Moreover, the doctrine of recoupment as set forth in the Bull case and Stone v. White, supra, is not available to the taxpayer, in any event, by reason of McEachern v. Rose."

2. The Sections are not Retroactive and do not Destroy Substantive Rights.

It seems clear that Sections 608(a) and 609(b) have no application to the present law suit. This is so for still another reason. When the Government forced the respondent to make payments to it in 1919, 1920, 1921 and 1922, at the moment each payment was made a legal right to get it back arose. The statute of limitations prevents the respondent from asserting that right in an offensive suit. But the right continues to exist and may be asserted defensively in a plea of recoupment. That it is a valuable substantive right is evident: it constitutes a complete defense to a deficiency assessment claim of $229,000. Surely a 1928 statute containing directions to the Commissioner concerning "credits" and "refunds" did not destroy the plaintiff's existing right to plead recoupment. At the most it did no more than close the Commissioner's ear to such an argument, and require the plaintiff to resort to a Court possessing general equity jurisdiction, to assert his right of recoupment. A statute will not be construed as destroying an existing right unless the legislative intent to do so is expressed in clear and unmistakable language, and even then the statute faces constitutional obstacles: 50 *American Jurisprudence* 500. "Every reasonable doubt is resolved against a retroactive operation of a statute": **Valleytown Tp. v. Women's Catholic Order** (CCA 4, 1940), 115 F. (2d) 459, 462; **U. S. v. St. Louis etc. Ry. Co.** (1926) 270 U.S. 1; **Hassett v. Welch** (1938), 303 U.S. 303; **Claridge Apartments Co. v. Commissioner** (1944), 323 U.S. 141.

The petitioner cites no case holding that Section 608, even if applicable, which it is not, should be applied retroactively to destroy a right of recoupment which existed on the effective date of the act.

Section 609(c) which provides "The provisions of this section shall apply to any credit made before or after the

enactment of this act" did not cut off a then existing right of recoupment. Further, this entire subsection (c) was completely eliminated from Section 609 when that section became Section 3775 of the Internal Revenue Code of 1939. There was also eliminated from Section 607 the parenthetical clause "whether before or after the enactment of this act", which is now Section 3770(2) of the Code. That code is the present law and was the law when this suit was started in 1943. It was the law when the claim for refund was filed in 1940 and denied in 1941.

In the one other case in which the question of the retroactive effect of the Act of 1928 has been considered, the Court held that even the Government could in 1941 assert a right of recoupment which existed when the act was passed: West Va. Pulp & Paper Co. v. McElligott (D.C. N.Y. 1941), 40 F. Supp. 765, 771. Judge Burke said:

> "The taxes sought to be recovered by these suits were paid long before the enactment of Sections 607 and 609. It is the policy of Section 609(a) 'to stimulate voluntary payment of taxes by giving the taxpayer an immediate refund right free from the danger that it will be credited against a stale deficiency'. Harvard Law Review, Vol. 52, 1939, Page 498. A consideration of this policy seems to indicate that Sections 607 and 609(a) should not be construed to have the retroactive effect of taking away the equitable defense of recoupment as applied to claims for refund of taxes assessed and paid before the enactment of those sections, which defense would otherwise be available. Neither McEachern v. Rose nor Lyeth v. Hoey, 2 Cir., 112 F. 2d 4, dealt with the retroactive aspect of the application of those sections and may not be considered as authorities holding that recoupment may not be had as to claims for refund of taxes assessed and paid before the enactment of those sections. 'A statute will not be construed as taking away a common-law right existing at the date of its enactment, unless that result

is imperatively required.' Texas & Pacific R. R. Co. v. Abilene Cotton Oil Co., 204 U. S. 426, 27 S. Ct. 350, 354, 51 L. Ed. 553; White v. Hopkins, 5 Cir., 51 F. 2d 159."

This decision was cited with approval by both of the courts below (R. 44, 53).

Point 4.

The rule that a taxpayer may not recover from one Collector of Internal Revenue moneys wrongfully paid to a predecessor collector has no application to the present case because the respondent only seeks to recover from the petitioner moneys paid to him which he had no right to collect.

The respondent sued the petitioner to recover from *him* the sum of $229,805.34 which had been paid to *him* on December 3rd, 1938. The theory is that *he* illegally collected this money as Collector of Internal Revenue because no money was owing to the Government by the respondent. The judgment of the Court below is that the respondent is entitled to recover back from the petitioner the money paid to *him*. The judgment does not require him to pay back moneys paid to any other Collector.

The petitioner's argument on pages 39 to 41 of its brief ignores the facts in the case and the fact that in tax litigation the position of the parties to the suit is generally the reverse of that in ordinary litigation.

The mere fact the Government was entitled to *assess* a deficiency tax for 1935 (the propriety of which is discussed infra) does not mean that it was entitled to *collect* it. The fact is the Government was not entitled to collect a penny of that assessment because the respondent's right of recoupment was a defense to the entire claim. Consequently no part of this assessment could be lawfully collected. However, rather than face the Government's exercise of its power to collect the assessment by summary process, the respondent paid the assessment under protest

and then sued to establish its right of recoupment. The petitioner Rothensies had no right to receive the payment made to him by the respondent and he had no right to keep it. He is only being required to pay back what *he* wrongfully received and wrongfully retained.

The petitioner contends that the respondent has worsened its position by paying the assessment and suing to recover it, and that by so doing it can no longer assert the defense of recoupment it could have made as a defendant in a suit brought by or on behalf of the Government. The established law is contrary to this contention and it was settled by Mr. Justice Roberts in Bull v. United States, supra, when he said at pages 262-263 of the U. S. reports:

> "The circumstance that both claims, the one for estate tax and the other for income tax, were prosecuted to judgment and execution in summary form does not obscure the fact that in substance the proceedings were actions to collect debts alleged to be due the United States. *It is immaterial that in the second case, owing to the summary nature of the remedy, the taxpayer was required to pay the tax and afterwards seek refundment.* This procedural requirement does not obliterate his substantial right to rely on his cross-demand for credit of the amount which *if the United States had sued him for income tax* he could have recouped against his liability on that score" (Italics added).

The money the respondent paid to this petitioner on December 3, 1938, and which it seeks to recover from him was paid by him to the Treasurer of the United States, as required by law: 26 U.S.C. §3950. The moneys the respondent seeks to recoup were also paid by the then Collector to the Treasurer of the United States as required by law. This is stipulated (R. 29). In addition, in this case a certificate of probable cause has been filed in the District Court (R. 46) so the judgment against the peti-

tioner will be paid by the Treasurer of the United States out of the moneys of the respondent now in his possession.

The Circuit Court of Appeals well said: "A recoupment claim in a tax case is not a suit against a collector at all, but only a defense against what the collector asserts. If this is technical, it is no more so than the argument which it answers" (R. 54).

It may also be noted that in *Stone v. White* this Court allowed the Government to recoup against a trustee a tax which should have been paid by the beneficiary. Different persons but the same interest were involved. In this case the Government is the one really interested because it received the excise taxes and also assessed and received the 1935 income taxes.

Point 5.

The Moneys Paid to the Respondent in 1935 as a Refund of Moneys Illegally Exacted from the Respondent in the Years 1922 to 1926 Were Improperly Assessed as Income in 1935 and Should be Treated as Income in the Earlier Years

In this case "every consideration of fair dealing" (R. 43, 51) calls for an affirmance of the judgment. We believe that what we have already said in this brief establishes the respondent's right, under rules of equity and good conscience, to hold its judgment. At most, the petitioner can only urge technicalities as reasons for a reversal, such as "the same transaction" rule in recoupment and the effect of the Act of 1928. In view of this, we are entitled to point out to this Court a technical reason for affirming the judgment and thereby accomplishing the result demanded by considerations of fair dealing.

We urged in the courts below that the payment of $1,395,515.35 received by the respondent on October 15, 1935, could not be treated (except for interest in 1935) as 1935 income. The courts held to the contrary (R. 39-42,

49). It may be noted that it was unnecessary for the courts below to decide this issue in respondent's favor because they held for the respondent on other grounds. We believe the point is technically sound and we raise it again here as a reason to sustain the judgment. In so doing we merely assert "additional grounds why the (judgment) should be affirmed." Our right to do so on the petitioner's appeal is clearly established by the opinion of Justice Brandeis in United States v. American Ry. Express Co. (1924), 265 U.S. 425, 435-436.

The material facts are these: Between June 1, 1922 and February 28, 1926 (and prior thereto), the respondent sold storage batteries. The money received from these sales was clearly gross income in the year received. The Government demanded that the respondent pay "excise taxes" on these sales. The respondent protested by letter dated April 28, 1919 (R. 22), and claimed no such payments were due but, under duress did, during the period in question, make payments totalling $825,151.52 (R. 22, 30). Subsequently the respondent brought suit to recover this money and sustained the position it had consistently taken from the time the "excise taxes" were first demanded in 1919. The $1,395,515.35 repaid to the respondent in 1935 represented this principal sum of $825,151.52 plus interest. The respondent did not return any of this amount as income received in 1935 (except for interest earned during that year) but the Commissioner treated the entire payment as 1935 income and made the deficiency assessment on it of $229,805.34 (R. 25-26). The claim for additional 1935 tax was paid under protest and this suit was instituted to recover it, following disallowance of claim for refund. We submit that the 1935 deficiency assessment was erroneous.

For income tax purposes the net income which is taxable is Gross Income less certain designated deductions permitted under the statutes and regulations. The receipts from battery sales are clearly gross income. Permissible

deductions from this include valid excise taxes paid or accrued. On the other hand, an accrued excise tax is not a permissible deduction where the tax is invalid and the taxpayer is contesting it: **Dixie Pine Products Co. v. Commissioner** (1944), 320 U.S. 516. That case held that the taxpayer cannot properly deduct a contested excise tax except in the taxable year in which it is adjudicated to be liable for the payment of the tax. If it is not so adjudicated the deduction can never be made. Consequently, in the present case the $825,151.52 paid by respondent under protest in the years 1922-26 were not proper deductions in those years, and the net income for income tax purposes for those years included this sum of money. If it was taxable income in those years the same sum of money cannot be taxable income again in 1935 merely because it was restored to the respondent's possession in that year. In the *Dixie Pine Products Co.* case the taxpayer kept its books on the accrual basis, and that is also the fact in the present case (R. 37).

After the respondent's protests, that these claimed excise taxes were not owing and that the payments would be illegal exactions, were overruled the respondent made the payments during 1922 to 1926 and claimed them as deductions in its income tax returns for the year in which the payment was made or accrued. The deductions were allowed. It seems clear, under the *Dixie Pine Products Co.* case, supra, that this allowance was an error. The Commissioner should have disallowed the deduction and said to the respondent: "You claim these taxes are illegal exactions. If they are you have merely changed the form of your asset from cash on hand into a valid claim for refund (as proved to be the case). No valid deduction can be taken until your liability, which you dispute, is settled."

The fact the Commissioner did not do this cannot change what was clearly income in 1922 into income in 1935 when all that happened in the latter year is that respondent's asset was changed back from a right to a re-

fund into its original form of cash on hand. The respondent was not responsible for the Commissioner's error. It has taken the consistent position from 1919 down to the present moment that it did not owe the Government any money for excise taxes on parts of automobiles; and from the beginning it has branded the payments it was compelled to make as illegal exactions (R. 22); and it finally proved its contention to be valid. The responsibility for the Commissioner's failure to make timely collections from respondent of the correct amounts due from it for income taxes for the years 1922-26 must be laid squarely on his door-step. There is nothing in this case on which the Government can base any argument that the respondent is estopped from making the point that the refund in 1935 is not income in that year.

The position we take, that a contested and wholly illegal tax collection which is later refunded is income for tax purposes in the year in which the money was originally earned by the taxpayer and not in the year in which the refund is received, is in accord with the previously settled practice in the Treasury Department, as set forth in the Commissioner's rulings, which were followed for many years. It is also in accord with decisions in several Circuit Courts of Appeal: Inland Products Co. v. Blair (CCA 4, 1929), 31 F. (2d) 867; Leach v. Commissioner (CCA 1, 1931), 50 F. (2d) 371, 373; Bergan v. Commissioner (CCA 2, 1935), 80 F. (2d) 89; cf. Cooperstown Corporation v. Commissioner (CCA 3, 1944), 144 F. (2d) 693, 696.

In 1920 in Office Decision 741 the Commissioner held that where a tax is illegally collected and later refunded adjustment should be made in the deduction year as a matter of a correction of a mistake, and that the amount refunded does not constitute income in the year in which the refund is received: Treasury Department, Bureau of Internal Revenue, Cumulative Bulletin No. 3, p. 115 (1920). In a ruling dated July 2, 1932, the Commissioner amended O.D.741 and said:

"A distinction should be made between (1) the ruling published as O. D. 741, supra, and (2) the decisions in the cases of the Chicago, Rock Island & Pacific Railway Co. (13 B. T. A. 988) and the Mixed Claims Commission awards. In the *former case the customs duties were illegally collected and were, therefore, void from the beginning.* It follows that the deductions from gross income were improperly taken and the income tax liability erroneously computed. *When the illegality of these payments was later established the refunds made did not constitute income,* since the original payments were payments made to the collector under mistake. *Readjustment of the returns for the years in which the mistakes were made was the logical method for remedying the situation.* In the latter cases, when the railroad company took deductions for the damage claims and wages and the insurance companies took deductions for the losses, they were strictly within their rights in so doing. The legality of those transactions and the deductions based thereon have never been questioned. There was involved in those cases no element constituting the correction of a mistake.

It is now held that *application of the ruling published as O. D. 741, supra, should be restricted to cases in which collections of customs duties and taxes were illegally or improperly made.* It sometimes happens that duties or taxes are legally or properly collected, but by reason of some subsequent event are refunded. * * * Therefore, legal and proper collections of customs duties and taxes should be distinguished from those illegally or improperly made. Refunds of customs duties or taxes, the collection of which was legally or properly made, should be treated as income for the year in which refunded": Treasury Department, Bureau of Internal Revenue, Cumulative Bulletin XI-2, pp. 33, 34-35, July 2, 1932 (Italics added).

Thus over a period of many years a clear course of administrative practice had been established and uniformly followed in the Treasury Department with respect to refunds of *illegal* tax payments.

Then on December 28, 1934, the Board of Tax Appeals decided Houbigant, Inc. v. Commissioner (1934), 31 B. T. A. 954. The facts were that in 1931 the taxpayer received a refund of a portion of customs duties paid during 1924-29 on goods which had been incorrectly classified. The duties as originally assessed had been included in the 1924-29 tax returns as "increased cost of goods" and had been allowed as such, but not as customs duties. The taxpayer paid one-half of the 1931 refund as attorney's fees and *voluntarily* returned the other one-half in its 1931 income tax return but claimed no deduction for attorney's fees.

After the statute of limitations against any deficiency assessment for the year 1924-29 had run the taxpayer filed a claim for refund of 1931 taxes claiming that the refund of one-half the customs duties had been erroneously included by it in gross income and that the other one-half paid as attorney's fees had been erroneously omitted from the deductions. A refund was paid on this basis. Later the Commissioner reversed his previous action and issued a notice of deficiency.

It will be noted that the taxpayer voluntarily treated the refund as 1931 income and then after the statute had barred the Commissioner from opening up the 1924-29 returns, the taxpayer suddenly changed his position. Further, the deductions in the 1924-29 returns had been allowed for "increased cost of goods." The facts establish a complete estoppel against the taxpayer's belated contention that he erred in returning the 1931 refund as 1931 income.

The Board held that, on these facts, the refund received in 1931 could be treated as income in 1931. The Second Circuit Court of Appeals affirmed without opinion: (1936) 80 F. (2d) 1012; and this Court denied certiorari: (1936) 298 U.S. 669.

On the facts the decision can be sustained on the ground of estoppel, but the statement of the Board that a refund of *illegally* collected taxes is income in the year the refund is received, is not supported by any case it cites and ignores the long settled administrative practice in the Treasury Department up to that time. It also ignores the distinction (emphasized in the Commissioner's 1932 ruling) between refunds of taxes *illegally* collected and refunds caused by subsequent events of taxes *lawfully* collected.

On its facts the *Houbigant* case is clearly distinguishable from the case at bar, and no one can quarrel with the result reached in it. But the Board's dictum is contrary to every prior court decision on the point and the long settled practice in the Treasury Department. It is flatly contrary to O. D. 741 which deals with the very question of the refund of overpaid customs duties, and which is not mentioned in the board's opinion.

The Board's dictum that a refund of taxes should be considered income in the refund year where limitations bar a reassessment of the returns for the earlier year was followed by the Board in Victoria Paper Mills Co. v. Commissioner (1935), 32 B. T. A. 666, which was affirmed without opinion in (CCA 2, 1936) 83 F. (2d) 1022.

In Nash v. Commissioner (1936), 34 B. T. A. 675, the taxpayer took credit in his 1926-31 income tax returns for state income taxes which were later declared invalid and refunded to him in 1932. *The taxpayer treated the refund as income received in 1932 and returned it as such.* After limitations barred a reassessment in the earlier years the taxpayer *changed his position* and filed a claim for refund. Here again the elements of estoppel are present. The Circuit Court of Appeals affirmed in a short opinion containing no discussion but merely citing the Houbigant case, and two other cases not in point: (CCA 7, 1937) 88 F. (2d) 477.

In Bohemian Breweries v. United States (Ct. Cl. 1939), 27 F. Supp. 588, the Court *held* that where the taxpayer had received a refund of excise taxes illegally col-

lected the Commissioner properly disallowed their original deduction in the returns for the year in which they were first paid. The Court *mentioned*, without any citation of authority to support it, "the rule that an amount deducted and allowed from income in a certain year must be included in income when collected or recovered in a subsequent year when the correction of the return and the tax liability in a prior year is barred by the statute of limitations": (p. 592) That is not an accurate statement of any established rule of law with respect to the refund of illegally collected taxes.

In **Union Trust Co. v. Commissioner** (CCA 7, 1940), 111 F. (2d) 60, a refund of estate tax was held to be taxable income of the estate in the year of receipt, because it was too late to reopen the estate's income tax returns for the year in which the estate tax had been deducted. The Court followed its own 1936 decision in the Nash case.

In **Ben Bimberg Co. v. Helvering** (CCA 2, 1942), 126 F. (2d) 412, the Court held that *purchase credits* given to the taxpayer in 1936 by a mill, pursuant to a contract made in 1935 providing for such credit in the event the AAA was declared unconstitutional, were properly treated as gross income in 1936. Although anything Judge Learned Hand says commands respectful consideration he was not *deciding* that refund of an illegal tax is not income in the year it was erroneously claimed as a deduction.

In **Hoboken Land & Improvement Co. v. Commissioner** (1942) 46 B. T. A. 495 the question whether a tax assessed in 1933 and deducted in that year and abated in 1936 is taxable income in the latter year was not a contested issue (46 B. T. A. at p. 503) and in the Circuit Court of Appeals the Court said "That phase of the case is not before the Court on this appeal": (CCA 3, 1943) 138 F. 2d 104, 108.

In **Freihofer Baking Co. v. Commissioner** (CCA 3, 1945) 151 F. 2d 383 the Court held that where the taxpayer paid processing taxes to a mill in 1935 and deducted

them from gross income in 1935 as a part of "costs of goods sold" and received a repayment from the mill in 1936 that repayment was 1936 income. The Court emphasized that the taxpayer was "positively liable in 1935 for the cost of the flour sold to it by the Mills" (p. 386).

The foregoing reviews all the decisions we have found on the point. There are eight cases in all starting with the *Houbigant* case, which is an estoppel case, as is the *Nash* case. In the *Bohemian Brewery*, the *Bimberg*, the *Hoboken Land & Improvement Co.*, and the *Freihofer Baking Co.* cases the question was not decided. In the *Victoria* case there is no opinion of the Circuit Court of Appeals to guide us. In the *Union Trust Co.* case the Court followed its earlier decision in the Nash case. In both cases the taxpayer had *voluntarily claimed* the original deductions which were later refunded.

On February 23, 1937, the Acting Commissioner of Internal Revenue issued a ruling in which he modified the earlier rulings and provided "that in the case of a refund in any year of customs duties or taxes illegally collected which have been taken as deductions in Federal Income Tax returns for a prior year, if the taxable year in which the deduction was taken is closed by the expiration of the period of limitation for the making of an additional assessment of income tax . . . the refund should be treated as income for the taxable year in which it was made": **Treasury Department, Bureau of Internal Revenue, Cumulative Bulletin 1937-1, pp 93-94 Mim. 4564.** The ruling cites the *Houbigant* and *Nash* cases, which are estoppel cases on their facts, but does not confine the ruling to such factual situations.

This is certainly a rule of expediency with a vengeance. It is difficult to see how illegally exacted money which would be 1939 income on June 10, 1945, if refunded on that date, becomes 1945 income when refunded on June 15, 1945, because the limitation period expired on June 12th.

The fortuitous circumstance of the date of limitations cannot be the test of what is income in a given year. Where this purported rule is applied to the refund of money illegally collected and paid under protest it is a pure device to evade the statute of limitations and enable the Commissioner to avoid the consequences of his own failure to make timely disallowance of deductions the taxpayer's own protest warns him are invalid. Furthermore its operation may be most unfair by putting the refund covering several years into a single taxable year governed by much higher tax rates and brackets and thus subject the taxpayer to a far greater tax than if assessed properly in the beginning. *Such a rule can only be supported when applied to a case in which the taxpayer's own conduct has lulled the Commmissioner into taking no action until after action is barred.*

Lurking behind the few opinions on this question is the thought that this so-called rule can be justified as a device of expediency, if not of logic, *to prevent an unjust enrichment of the taxpayer.* But every statute of limitation permits some unjust enrichment and it is doubtful that this is a sound reason. However, it is the only reason by which the rule can possibly be justified *and that reason is not present in the case at bar* because the calculation on page 4 of this brief shows that the Government has received more money from the respondent, without the 1935 deficiency assessment, than it was entitled to collect and that it is the Government, not the respondent, which is unjustly enriched in this case. Consequently there is no possible justification for applying the "rule" to the present facts.

CONCLUSION.

The refunded taxes, which were illegally collected, were not income to the respondent in the year 1935 under sound accounting practices, and their treatment as such was improper. Since the Commissioner was responsible and had adequate opportunity in all pertinent years to make proper adjustment there is no justification in equity or in law for permitting the Commissioner to include in income in a single year all the refunded taxes, thus imposing a penalty on the respondent for which it was in no way responsible.

Secondly, the respondent is entitled to recoupment in any event to the extent of the net amount of the illegally collected excise taxes. The judgment should be affirmed.

Respectfully submitted,

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APPENDIX

McEachern v. Rose (1937), 302 U.S. 56

Analysis of Pleadings, Issues in the Case, Points Argued in the Supreme Court, and Decision of the Supreme Court.

The plaintiff instituted suit in the District Court of the United States for the Northern District of Georgia on September 11, 1934. The petition was in three counts, a separate count being used to set forth the claim to recover overpayments of income taxes for the years 1929, 1930 and 1931, respectively. The suit was in the nature of indebitatus assumpsit. The defendant's answer was filed on March 9, 1935, and set up the following defense to the first count:

"In view of the acts of the Commissioner in relying in good faith upon and accepting plaintiff's sworn tax returns as aforesaid for these four years (1928-31) as correct . . . *it would be unconscionable* for the plaintiff to be allowed any recovery from the defendant as an overpayment of its 1929 income tax . . . and thereby leave the defendant without any existing available remedy to enforce collection from the plaintiff of tax that would be due for the year 1928 under the theory the plaintiff now seeks to advance."

The same language was used in the answer to the second and third counts. The defendant also pleaded that "the plaintiff is estopped to assert and claim" his right to recover the overpayments.

The District Court directed a verdict for the plaintiff but did not file an opinion. The Fifth Circuit Court of Appeals reversed and said "because his action is equitable in its nature and grounds, . . . he may not succeed in it unless he can show that the defendant has money which, ex aequo et bono, the defendant ought to refund": 86 F. 2d 231, 233. The Court relied primarily upon the famous decision of Lord Mansfield in *Moses v. McFarlane* (1760) 2

Burroughs 1005, in which he outlined the nature and scope of an action of indebitatus assumpsit. The Court concluded that such an action "may not be used to obtain money which the plaintiff ought not, in good conscience, to have back."

In the petition for a writ of certiorari, the only reason for granting the writ set forth in the petition was that "the decision of the Circuit Court of Appeals in the case at bar is in conflict, on the question of estoppel, with" cited decisions of the Supreme Court and other Circuit Courts of Appeal. In the Solicitor General's brief in opposition to the writ, the Solicitor General said "The decision of the Circuit Court of Appeals does not rest on estoppel. It rests on recoupment". The petitioner filed a reply memorandum saying, with respect to this, "it may be observed that the opinion nowhere refers to recoupment or otherwise indicates that the Court below relied on the doctrine of recoupment."

Following the granting of a writ of certiorari, the briefs, on the merits of the appeal, were filed. The *Petitioner's Brief* said:

"The petitioner next contends that the issue of recoupment is not open for consideration in this case. A plea of recoupment must allege the existence of a claim, must state the amount of the claim, and must pray that such claim be set up to reduce or wipe out the main cause of action. None of these three essentials is found in any pleading filed by the respondent. The petitioner, therefore, contends that the issue of recoupment is not open" (p. 7).

. . . . . .

"In its pleadings and at the trial of the case in the District Court the respondent relied solely upon the defense of estoppel. . . . *Of particular significance is the fact that nowhere do such pleadings set forth any amount to be recouped.* . . . Certainly the respondent cannot come in at this late date and assert a defense of recoupment on a record where no recoupment was pleaded or raised in any way in the trial court" (pp. 24-25).

In the *Solicitor General's Brief*, in his Summary of Argument, he said:

"This is an action for money had and received, based on equitable principles, in which petitioner must show that respondent wrongfully withholds money equitably due petitioner. Where, as here, the money received by respondent, though received under a technical mistake in procedure under the revenue laws, was no greater than was justly due from petitioner as taxes on the income, no right of recovery in this form of action exists. Stone v. White, 301 U. S. 532. No violation of the statute of limitations results from the application of these equitable principles to this case" (p. 7).

He said further:

"Respondent has not been unjustly enriched at the expense of petitioner. . . . In view of the equitable character of the petitioner's action, he should not be allowed to undo the payments actually made and escape taxation upon the transaction altogether" (p. 9).

"The action here is a suit against the Collector for a refund of income taxes, as was the action in Stone v. White. All that was said there concerning the equitable nature of the proceeding as a successor of the common count in *indebitatus assumpsit* for money had and received, is fully applicable here" (p. 11).

"Petitioner's brief argues that the defense of 'recoupment' is not open under the pleadings. The defense relied upon by the respondent, by whatever name called, was urged in both courts below . . ." (p. 16).

"The defense in question, although in the nature of an equitable recoupment, *is not strict recoupment* but rests upon the necessity that the plaintiff in an action of this kind prove that he is justly and equitably entitled to the money he seeks. Respondent in this case was entitled to show any state of facts which would deny the equity of petitioner's claim, even if the answer went no further than a general plea of non-assumpsit, . . ." (p. 17).

In the *Petitioner's Reply Brief*, in answer to this last statement, the petitioner said that the Georgia practice, which was controlling, "does not recognize the plea of non-assumpsit". He added:

"The amounts paid for 1930 and 1931 would be refundable even if they had been paid and received as taxes for 1928. This follows from the fact . . . the statute of limitations had run. . . . Under Section 607 of the Revenue Act of 1928 any amounts collected as tax after the expiration of the limitation period are deemed overpayments and are refundable". (p. 3).

On page 7 of *Petitioner's Reply Brief*, he referred to "the express commands of Sections 607 and 609 of the Revenue Act of 1928".

These are the only references in the briefs filed on behalf of the parties to Section 607, 608 and 609 of the Revenue Act of 1928. These sections are not even mentioned in the Solicitor General's brief and no analysis of their application or scope is presented.

In addition to the briefs of the parties, the Court also had before it the *Brief of an Amicus Curiae* which contained the following statements:

"Whatever may be the origin of the action to recover taxes overpaid and whatever may be the common law restriction upon an action for money had and received, it is clear that the present suit is an action to recover amounts, *the refund of which is expressly commanded by statute, and that it is only necessary*, as in any other legal action to enforce a statutory right, *to show that the statute requires the payment of money*—not to show that in equity and good conscience plaintiff is entitled to the money. It may be that a common law right would subsist if Congress should take away the statutory right, but so long as the statutory right expressly given by Congress remains, equity is not a matter of importance.

"This Court in Bull v. United States, 295 U. S. 247, 15 A. F. T. R. 1069, truly expressed the nature of the action to recover taxes overpaid. It said that the action is essentially

one by the Government to test the correctness of the summary collection which for reasons of public policy it must be permitted to make before its legal right to the money is tested. It says that the taxpayer in such a suit is not really a plaintiff, but that he is actually a defendant and as such can plead recoupment. This holding was essential to the result reached in the Bull case. If the taxpayer is a defendant in such a suit, where he is clearly entitled to rely upon all his legal defenses, *by what magic could he be converted in the present suit into a plaintiff in an action ex aequo et bono?*" (p. 2).

. . . . . .

"It is respectfully submitted that when consideration is given to all the pronouncements of this Court on the subject of the nature of an action to recover taxes overpaid, and to the cases where the action is admittedly available to recover money which was owed by the taxpayer and which he is not ex aequo et bono entitled to have refunded, as in cases where the sole ground of recovery is that the tax was paid after the statute of limitations had run, this Court will not adhere to any view that an action for recovery of taxes is an action equitable in nature dependent upon a showing that the Government has money to which, in justice and equity, plaintiff is entitled. *On the contrary this Court must hold that the action is legal in nature and dependent only upon a showing that the taxes sued for have been overpaid.*

"That does not mean that an action to recover taxes overpaid is not, like all other legal actions, subject to certain equitable defenses, but it does mean that an action to recover back taxes is subject only to such defenses as would at the time the taxes were collected *have permitted the Government to prevail in an action against the taxpayer.* If the taxpayer has acted in such a way in some other taxable period as to deprive himself of the right to insist that his taxes for the taxable period in question be computed on what would under the statute alone be the correct basis—as where he has misrepresented a fact in an earlier year to

the detriment of the Government and is in the later year held bound by that misrepresentation—he might be denied a refund to which, under the strict provisions of the statute alone, he would be entitled. But recovery would be denied, not upon the ground that the action to recover taxes is equitable or that a taxpayer is not definitely entitled to recover an admitted overpayment of taxes without regard to equities, but upon the ground that, under the facts which he has a right to present, no overpayment is shown to have occurred.

"A holding that, where there has occurred an admitted overpayment of taxes which the Government could not legally have collected, such overpayment may not be recovered back because of some theory of inequity, would lead to most deplorable results. It would be most unfortunate if an officer, clothed with the vast power of summary action which rests with the Commissioner of Internal Revenue, could, by collection of amounts not due or barred by the statute of limitations, place himself in a better position to *keep* such money than he would have been in to *collect* it, had he been compelled to sue. Such a holding would invite lawlessness on the part of officials.

"To permit the Government under such circumstances to retain illegal collections would necessitate the widespread use of injunctions against the collection of taxes" (pp. 5-6).

"It is believed that this Court can search in vain through the revenue statutes for any suggestion that Congress has ever contemplated any such holding except under certain special circumstances expressly provided for by Congress. Congress has generally shown a very wise desire to have taxpayers feel that they can make prompt payment of any taxes claimed from them, or which upon their own computation they feel they may owe, with the full assurance that if the taxes have been overpaid, that is, if the amounts paid are not such as the Commissioner could have legally collected for the year for which paid, the amounts so overpaid will be refunded or credited against unbarred

liabilities which are collectible against the taxpayer" (p. 7).

"Sections 607 and 609 of the Revenue Act of 1928 require absolutely that amounts collected by payment or credit after the statute has run shall constitute an overpayment and expressly direct that 'it shall be refunded', provided only that a claim for refund is filed within time. Congress had already provided in 1924 that suit for refund could be maintained to recover a tax overpaid, although the payment was not made under protest. Congress has thus attempted in every way to see that a taxpayer is not deprived of the benefit even of the statute of limitations because the Government may wrongfully collect or he may ignorantly pay a barred tax, without any regard whatever to whether *ex aequo et bono* the tax was owed. Certainly there is no reason for this Court sanctioning any departure from the sound policy laid down by Congress even if it properly had authority to do so" (p. 8).

From these quotations it will be noted that the whole emphasis in this brief of the *Amicus Curiæ* was that the taxpayer has an absolute statutory right to get back an overpayment and that the Government cannot defeat this right by general notions of unjust enrichment and historical limitations on the scope of indebitatus assumpsit. This argument apparently impressed the Court and was the reason for the reversal of the decision of the Circuit Court of Appeals. In the opinion of the Supreme Court *Mr. Justice Stone* said (302 U.S. 56, 59):

"We may assume that, in the circumstances, equitable principles would preclude recovery in the absence of any statutory provision requiring a different result. But Congress has set limits to the extent to which courts might otherwise go in curtailing *a recovery of overpayments of taxes* because of the taxpayer's failure to pay other taxes which might have been but were not assessed against him" (Italics added).

He referred to Section 607 and Section 609(a) of the Revenue Act of 1928 and said further (p. 60):

"These provisions preclude the Government from taking any benefit from the taxpayer's overpayment by crediting it against an unpaid tax whose collection has been barred by limitation."

From this language of Mr. Justice Stone it seems clear that the Court was holding as a matter of policy, that when the taxpayer makes an overpayment and brings suit to recover it, he is not to be put in a worse position than he would have been in if he had refused to make the payment. The brief of the *Amicus Curiæ* had strongly emphasized the importance of having taxpayers believe they may make overpayments in cases of disputes with a clear understanding that they can obtain a refund later if the Government erred.

We submit that these reasons of policy have no application when applied to the converse situation and it does not follow that Section 608 and Section 609(b) prevent *courts possessing general equity jurisdiction* from applying the doctrine of equitable recoupment in favor of the taxpayer.

The decision of the Supreme Court does not establish that Sections 608 and 609(b) are anything more than administrative provisions to govern the conduct of the Commissioner of Internal Revenue. In fact it does not mention them.

Further, it should not be overlooked that the doctrine of equitable recoupment as such was not raised on the pleadings in this case. This is emphasized in the article "Recoupment in Federal Taxation" (1942), 28 Va. Law Review 577, 594.

In any event we submit that at the most this decision of the Supreme Court does no more than prevent *the Government* from raising the defense of equitable recoupment and that this result is based upon reasons of policy which are not applicable to a taxpayer who seeks to raise the de-

fense of recoupment. Consequently, so far as the taxpayer is concerned, the rule laid down in Bull v. U. S., 295 U. S. 247, is still controlling. This conclusion is strengthened by the fact that the Court cited the Bull case with apparent approval in 1943, six years after the decision in McEachern v. Rose: Commissioner v. Gooch M. & E. Co., 320 U.S. 418, 421.

SUPREME COURT OF THE UNITED STATES

No. 48.—October Term, 1946.

Walter J. Rothensies, Individually and as United States Collector of Internal Revenue for the First District of Pennsylvania, Petitioner, v. The Electric Storage Battery Company.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[December 16, 1946.]

Mr. Justice Jackson delivered the opinion of the Court.

This case represents an effort, thus far successful, to obtain advantage by way of recoupment of a claim for tax refund long since barred by the statute of limitations. The facts of this singular situation are not in dispute. From April 1919 to April 1926 the Electric Storage Battery Company paid excise taxes on the sale of storage batteries in the belief, shared by the Government, that such sales were subject to tax. In July of 1926 the company asserted otherwise and filed a refund claim. It asked refund only of that part of the taxes which it had paid between 1922 and 1926. Refund of the taxes paid earlier which the company now seeks to recoup were then barred by the statute of limitations and no claim ever has been filed for their refund and no action ever was begun for their recovery. Suit was brought, however, against the Collector for refund of the taxes paid after July 1922; judgment therefor was obtained in the district court and affirmed by the Circuit Court of Appeals. The Government finally settled by refund of $1,395,515.35, of which $825,151.52 represented tax and the balance interest.

During the years that the refunded excise tax was being collected, the taxpayer deducted it from income before calculation of its income tax, thereby deriving substan-

Electric Storage Battery Co., 327 U. S. 774.

tial benefits. The Commissioner, therefore, treated the refund as income for 1935, the year in which it was received, and because of it assessed additional income and excess profits taxes which with interest thereon totaled $229,805.34. The taxpayer paid the deficiency, filed claim for refund, and after it was rejected sued the Collector. It contended that the refund from the Government was not income to the taxpayer but that if it were so considered taxpayer should be permitted, as against the additional tax caused by its inclusion, to recoup the amount of the barred excise taxes which it had paid between 1919 and 1922. Both courts below correctly held that the refund was properly assessed as income. *Cf. Security Flour Mills Co.* v. *Commissioner*, 321 U. S. 281; *Freihofer Baking Co.* v. *Commissioner*, 151 F. (2d) 383. Both have held, however, that the income tax liability for 1935 should be extinguished by recoupment of the 1919 to 1922 excise taxes. The gravity of this holding to the administration of the tax laws led us to grant certiorari. *Rothensies* v. ~~United States Electric Storage Battery Co.~~, 327 U. S. 774.

It is not contended that there is any statutory warrant for allowing barred tax refund claims by way of recoupment or otherwise.[1] Authority for it is said to be found in case law and taxpayer relies chiefly on two decisions of this Court, *Bull* v. *United States*, 295 U. S. 247, and *Stone* v. *White*, 301 U. S. 532. The essence of the doctrine of

[1] Indeed, the applicable provisions of the Revenue Act of 1928 seem to direct a result opposite to that asked by respondent. Section 608 provides that "A refund of any portion of an internal-revenue tax (or any interest, penalty, additional amount, or addition to such tax) made after the enactment of this Act, shall be considered erroneous— (a) if made after the expiration of the period of limitation for filing claim therefor, unless within such period claim was filed; . . ." Section 609 (b) provides, "A credit of an overpayment in respect of any tax shall be void if a refund of such overpayment would be considered erroneous under section 608." 45 Stat. 874, 875. And *cf. McEachern* v. *Rose*, 302 U. S. 56.

recoupment is stated in the *Bull* case: "recoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded." 295 U. S. 247, 262. It has never been thought to allow one transaction to be offset against another, but only to permit a transaction which is made subject of suit by a plaintiff to be examined in all its aspects, and judgment to be rendered that does justice in view of the one transaction as a whole.

The application of this general principle to concrete cases in both of the cited decisions is instructive as to the limited scope given to recoupment in tax litigation. In both cases a single transaction constituted the taxable event claimed upon and the one considered in recoupment. In both, the single transaction or taxable event had been subjected to two taxes on inconsistent legal theories, and what was mistakenly paid was recouped against what was correctly due. In *Bull* v. *United States*, the one taxable event was receipt by executors of a sum of money. An effort was made to tax it twice—once under the Income Tax Act as income to the estate after decedent's death and once under the Estate Tax Act as part of decedent's gross estate. This Court held that the amount of the tax collected on a wrong theory should be allowed in recoupment against an assessment under the correct theory.[2] In *Stone* v. *White*, likewise, both the claim and recoupment involved a single taxable event, which was receipt by an estate of income for a period. The trustees had paid the income tax on it but this Court held it was taxable to the beneficiary. Assessment against the beneficiary had meanwhile become barred. Then the trustees sued for a refund, which would inure to the beneficiary. The Court treated the transaction as a whole and allowed recoupment of the tax which the beneficiary should have paid

[2] But the Court emphasized that refund of the incorrect tax was not barred by the statute at the time the Government proceeded for collection of the correct tax.

against the tax the Government should not have collected from the trustees. Whatever may have been said indicating a broader scope to the doctrine of recoupment, these facts are the only ones in which it has been applied by this Court in tax cases.

The Government has argued that allowance of the claim of recoupment involved here would expand the holding in the *Bull* case. The Circuit Court of Appeals agreed that in the *Bull* case "the main claim and recoupment claim were more closely connected than they are here." *Electric Storage Battery Co.* v. *Rothensies*, 152 F. (2d) 521, 524. But the court nevertheless allowed the claim because it considered that this Court had introduced the doctrine of recoupment into tax law and that it was "based on concepts of fairness." 152 F. (2d) 521, 524. It said it saw no reason for narrowly construing the requirement that both claims originate in the same transaction. We think this misapprehends the limitations on the doctrine of recoupment as applied to tax law and it leads us to state more fully reasons for declining to expand the doctrine beyond the facts of the cited cases.

It probably would be all but intolerable, at least Congress has regarded it as ill-advised, to have an income tax system under which there never would come a day of final settlement and which required both the taxpayer and the Government to stand ready forever and a day to produce vouchers, prove events, establish values and recall details of all that goes into an income tax contest. Hence, a statute of limitation is an almost indispensable element of fairness as well as of practical administration of an income tax policy.

We have had recent occasion to point out the reason and the character of such limitation statutes. "Statutes of limitation, like the equitable doctrine of laches, in their conclusive effects are designed to promote justice by preventing surprises through the revival of claims that have been allowed to slumber until evidence has been lost, mem-

ories have faded, and witnesses have disappeared. The theory is that even if one has a just claim it is unjust not to put the adversary on notice to defend within the period of limitation and that the right to be free of stale claims in time comes to prevail over the right to prosecute them." *Order of Railroad Telegraphers* v. *Railway Express Agency*, 321 U. S. 342, 348–9. "They are by definition arbitrary, and their operation does not discriminate between the just and the unjust claim, or the voidable [avoidable] and unavoidable delay. They have come into the law not through the judicial process but through legislation." *Chase Securities Corp.* v. *Donaldson*, 325 U. S. 304, 314.

As statutes of limitation are applied in the field of taxation, the taxpayer sometimes gets advantages and at other times the Government gets them. Both hardships to the taxpayers and losses to the revenues may be pointed out.[3] They tempt the equity-minded judge to seek for ways of relief in individual cases.

But if we should approve a doctrine of recoupment of the breadth here applied we would seriously undermine the statute of limitations in tax matters. In many, if not most, cases of asserted deficiency the items which occasion it relate to past years closed by statute, at least as closely as does the item involved here. *Cf. Hall* v. *United States*,

[3] In *American Light & Traction Co.* v. *Harrison*, 142 F. (2d) 639, the court did not allow recoupment to the Government. But judiciously, it said, "Although here a hardship on the Government results from taxpayer's inconsistency, the correlative provisions of this same statute will, in the converse of the instant situation, work an equal hardship on the taxpayer." 142 F. (2d) 639, 643. Whether or not the statute, §§ 608 and 609 of the Revenue Act of 1928, be taken to compel the conclusion we reach in this case, the court's recognition that both parties to taxation are affected impartially, though perhaps harshly, by policy of repose has application here. It may easily be overlooked, when the unfairness of the Government's retaining incorrectly collected monies of respondent is stressed, that the statute of limitations is primarily an instrument of fairness.

43 F. Supp. 130. The same is true of items which form the basis of refund claims. Every assessment of deficiency and each claim for refund would invite a search of the taxpayer's entire tax history for items to recoup. This case provides evidence of the extent to which this would go. When this suit was brought in 1943, the claim pleaded as a recoupment was for taxes collected over twenty years before and for over sixteen years barred by the statute. That claims dead so long can be resurrected under this doctrine, is enough to show its menace to the statute of limitations—at least as to those taxpayers whose affairs by accident or design take such shape that they can avail themselves of recoupment remedies. Moreover, we have held that the Tax Court has no jurisdiction to consider recoupment. *Gooch Milling and Elevator Company* v. *Commissioner*, 320 U. S. 418. Hence, the availability of the remedy would depend on diverting the litigation to the district courts.

We cannot approve such encroachments on the policy of the statute out of consideration for a taxpayer who for many years failed to file or prosecute its refund claim. If there are to be exceptions to the statute of limitations, it is for Congress rather than for the Courts to create and limit them.

The judgment below is

Reversed.

MR. JUSTICE MURPHY is of the opinion, in which MR. JUSTICE BLACK and MR. JUSTICE RUTLEDGE join, that the judgment below should be affirmed. He believes that the claims for refund of the illegal assessments exacted from 1919 to 1922 arise out of the same subject matter as was involved in the Government's demand for additional taxes for 1935, thereby making applicable the rule of *Bull* v. *United States*, 295 U. S. 247.